

# **Report of the auditor-general to the Eastern Cape Provincial Legislature and the council on Mbizana Local Municipality**

## **Report on the financial statements**

### **Introduction**

1. I have audited the financial statements of the Mbizana Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2015, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget information with actual information for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

### **Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) and the Division of Revenue Act of South Africa, 2014 (Act No. 10 of 2014) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-general's responsibility**

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the municipality preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

## Basis for qualified opinion

### Property, plant and equipment

6. The municipality did not account for its property, plant and equipment (PPE) in accordance with GRAP 17- *Property, plant and equipment*. Not all infrastructure assets (Roads) were recorded in the fixed assets register and infrastructure assets (Roads) which were recorded in the fixed assets register were not valued correctly. As a result, Infrastructure assets of R477,1 million (2014: R410,3) million included in PPE as disclosed in note 4 are understated due to the nature of the assets. It is impracticable for me to determine the full extent of the understatement.

### Depreciation and amortisation

7. I was unable to obtain sufficient appropriate audit evidence for the reconciling difference between depreciation and amortisation as disclosed in note 4 to the financial statements of R 22,5 million and the depreciation and amortisation of R37,6 million as disclosed statement of financial performance. Due to a lack of daily and monthly financial disciplines it was impracticable to confirm the full extent of the error. Consequently, I was unable to determine whether any adjustment to the depreciation and amortisation as disclosed in note 4 of R22,5 and in the statement of financial performance of R37,6 million to the financial statements was necessary.

### Grant related expenditure

8. The municipality did not capitalise all items of property, plant and equipment in accordance with GRAP 17 - *Property, plant and equipment*. Additions to property, plant and equipment (PPE) were incorrectly recognised as grant related expenditure. Consequently, grant related expenditure as disclosed in the statement of financial performance was overstated by R9,6 million and PPE disclosed in note 4 and on the statement of financial position was understated by the same amount.

### Cash flow statement

9. GRAP1 - *Presentation of Financial Statements* requires that the financial statements present fairly the financial position, financial performance and cash flow of the municipality. Re-performance of the cash flow statement identified fundamental errors in the calculation of cash flows and discrepancies between the figures presented on the cash flow statement, cash generated from operations disclosed in note 34 and notes to the financial statements. This resulted in a net unreconciled difference for the following items:
  - No supporting calculations were provided for other non-cash movements in the cash generated from operations amounting R34,9 million.
  - Movement for the increase in VAT receivable of R10,9 million and decrease in VAT payable of R7,10 million was not taken into account when calculating the cash generated from operations.
  - Depreciation and amortisation per note 34 of R37,7 million did not agree to the amount per the property, plant and equipment note, note 4, that amounted to R22,5 million.
10. Consequently, the cash flow statement and note 34 is misstated in the financial statements.

## **Other receivables from exchange transactions**

11. Other receivables from exchange transactions as disclosed in note 9 of R3,1 million (2014: R3 million) in the financial statements were not adequately recognise in terms of GRAP 104 - *Financial Instruments* as the provision for bad debts was not considered on Other receivables. This resulted in an overstatement of other receivables from exchange transactions in the statement of financial position and understatement of the related provision for bad debts in the statement of financial performance.

## **Qualified opinion**

12. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of Mbizana Local Municipality as at 30 June 2015 and its financial performance and cash flows for the year then ended, in accordance with SA standards of GRAP and the requirements of the MFMA and DoRA.

## **Emphasis of matter**

### **Restatement of corresponding figures**

13. As disclosed in note 39 to the financial statements, the corresponding figures for 30 June 2014 have been restated as a result of errors discovered during 2015 in the financial statements of the Mbizana Local Municipality at, and for the year ended, 30 June 2014.

### **Material losses**

14. As disclosed in note 41 to the financial statements, material losses to the amount of R4,8 million were incurred as a result of electricity distribution losses.

### **Material impairments**

15. As disclosed in note 10 and 12 to the financial statements, cumulative provisions for impairments of R3,7 million (2014: R2,9 million) relating to receivables from non-exchange transactions and R8,3 million (2014: R6,7 million) relating to receivables from exchange transactions were incurred as a result of irrecoverable trade debtors.
16. As disclosed in the statement of financial performance and note 28 to the financial statements, debt impairments totalling R2,6 million (2014: R3,1 million) have been expensed.

### **Irregular and fruitless and wasteful expenditure**

17. As disclosed in notes 43 and 44 to the financial statements, fruitless and wasteful expenditure of R 110 898 (2014: R4,4 million) and irregular expenditure of R3,5 million (2014: R7,2 million) were incurred as a result of interest on late payment of suppliers and irregular expenditure being in contravention of the supply chain management policy and legislation.

## **Additional matter**

18. I draw attention to the matter below. My opinion is not modified in respect of this matter.

### **Unaudited supplementary schedules**

19. The supplementary information set out on pages xx to xx, does not form part of the financial statements and is presented as additional information. I have not audited these schedules, and, accordingly, I do not express an opinion thereon.

## **Report on other legal and regulatory requirements**

20. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading, but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

## **Predetermined objectives**

21. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2015:

- Development priority 4 : Community Services
- Development priority 5: Engineering Services

22. I evaluated the reported performance information against the overall criteria of usefulness and reliability.

23. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development priorities. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).

24. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

25. I did not raise any material findings on the usefulness and reliability of the reported performance information for the selected development priorities.

## **Additional matters**

26. Although I raised no material findings on the usefulness and reliability of the reported performance information for the selected development priorities, I draw attention to the following matter:

### **Achievement of planned targets**

27. Refer to the annual performance report on pages x to x for information on the achievement of the planned targets for the year.

### **Adjustments of material misstatements**

28. I have identified material misstatements in the annual performance report submitted for auditing on the reported performance information of the reported performance information for development priority 5: engineering services. As management subsequently corrected the misstatements we did not raise any material findings on the usefulness and reliability of the reported performance information.

## **Compliance with legislation**

29. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

### **Annual financial statements and annual reports**

30. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of , general expenditure, payables, Property, plant and equipment, Value added tax and commitments identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided subsequently but the uncorrected material misstatements and not be corrected, which resulted in the financial statements receiving a qualified opinion.

### **Asset management**

31. An effective system of internal control for assets including an asset register was not in place, as required by section 63(2)(c) of the MFMA however significant adjustments were made to the asset register submitted.

### **Liability management**

32. An adequate management, accounting and information system which accounts for liabilities was not in place, as required by section 63(2)(a) of the MFMA .
33. An effective system of internal control for liabilities (including a liability register) was not in place, as required by section 63(2)(c) of the MFMA.

### **Expenditure management**

34. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA

35. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA. Duplicate payments were made even though these are under investigations, they could have been prevented if controls were in place.

## Procurement and contract management

36. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by SCM regulation 17(a) & (c).

## Internal control

37. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the findings on compliance with legislation included in this report.

## Leadership

38. Management did not perform an adequate review of the financial statements for audit. As a result, corrections were made to the financial statements. There has been inadequate oversight by leadership and a slow response to the key messages. This was due to management not effecting timeous change in the municipality. Improvement is dependent on the proper execution of the action plans drafted, which were not fully implemented in the current year.

## Financial and performance management

39. Management did not adequately review financial statements and annual performance report before submission for audit. This resulted in various misstatements in the financial statements and a material misstatement in the performance report. Senior management did not adequately respond to our recommendations resulting in internal controls not improving.
40. There are ineffective tools to enable the regular review and monitoring of compliance with laws and regulations.

## Governance

41. There was no effective oversight review over financial information and compliance with laws and regulations as recurring findings in these areas were identified during the year.

*Auditor-General*

East London

30 November 2015



*Auditing to build public confidence*